MALAYAN BANKING BHD

v.

CHONG HIN TRADING CO SDN BHD & ORS

HIGH COURT MALAYA, KUALA LUMPUR
ABDUL WAHAB PATAIL J
[CIVIL SUIT NO: 22-3559-98]
1 MARCH 2001

CONTRACT: *Guarantee - Charging of penalty interest - Whether contrary to Section 75 of Contracts Act 1950 - Whether actual damage to be proved - Consideration - Whether past consideration - Effect of s. 80 of Contracts Act 1950*

This is an appeal by the defendants from the decision of the learned senior assistant registrar who had allowed the plaintiff to enter summary judgment under O. 14 of the Rules of the High Court 1980. From the facts, the plaintiff had made an offer of a loan to the first defendant on 6 June 1996. There was a term included in the loan offer and memorandum of charges of the charging of a penalty interest of 1%. The loan was thereafter disbursed after the memorandum of charges were executed. The second and third defendants had executed a guarantee in respect of the loan.

The issues that were raised in this case were whether; i) penalty interest is contrary to s. 75 of the Contracts Act 1950; ii) in view of s. 80 of the Contracts Act 1950, the guarantee is null and void because the loan is a past consideration.

Held:

[1] From the available evidence, the 1% interest in the memorandum of charges is clearly described as penalty interest. Subsequently, s. 75 remains applicable to render the default interest provision in the memorandum of charges unenforceable.

[1b] As a penalty interest, the effect of s. 75 is to require the plaintiff to prove its damages or loss and the 1% operates as the upper limit that may be claimed as damages. However, the plaintiff must prove the damages that it suffered, the established measure for which are the damages for the loss of use of the fund or money.

[2] The second and third defendants relied on s. 80 on the grounds that they signed the letters of guarantee on 12 September 1996 when the loan agreement was made on 6 June 1996. However, this ground was found

to be incomplete in that it fails to take into account that the loan was disbursed on 1 October 1996, that is, after the memorandum of charges and the letter of guarantee had been signed by the principal debtor and the second and third defendants.

[2b] The plaintiff's letter of offer dated 6 June 1996 contained specific conditions requiring pledges of shares and the joint and several guarantee of the second and third defendants. An agreement with conditions yet to be performed cannot be termed as a past consideration within the meaning of s. 80 where the execution of the guarantee is itself a pre-condition for the performance of the loan by the plaintiff by the release of the loan on 1 October 1996.

[3] Since the issues raised are purely legal in nature and do not involve findings upon disputed facts, the court would vary the order of the learned senior assistant registrar by deducting therefrom the penalty interest of 1% and order that leave is given to the defendants to defend upon the issue of actual damage suffered by the plaintiff as a result of the default.

[Order accordingly.]

Case(s) referred to:

Bumiputra Merchant Banker Bhd v. The Melewar Corporation Berhad & Ors [1990] 2 CLJ 30 ***(refd)***

Chew Soon Tat v. Malaysia National Insurance Sdn Bhd [1977] MLJ 241 ***(refd)***

D & C Bank Bhd v. Syarikat Farmco Sdn Bhd & Ors [1988] 3 MLJ 275 ***(refd)***

Heng Cheng Swee v. Bangkok Bank Ltd [1976] 1 MLJ 267 ***(refd)***

Hong Leong Finance Ltd v Tan Gin Huay & Anor [1999] 2 SLR 153 ***(refd)***

Perbadanan Kemajuan Negeri Selangor v. Public Bank Bhd [1980] 1 MLJ 172 ***(refd)***

Perwira Habib Bank Malaysia Bhd v. MET Sdn Bhd & Ors [1988] 2 CLJ 480 ***(refd)***

Perwira Habib Bank Malaysia Bhd v. Saiyo Sdn Bhd & 2 Ors [1991] 3 CLJ 1849 ***(refd)***

Perwira Habib Bank Malaysia Berhad v. Utara Realty Sdn Bhd & Ors, Suit No. C3-23-3100-86 ***(refd)***

Realvest Properties Sdn Bhd v. Co-operative Central Bank Ltd [1996] 3 CLJ 823 ***(refd)***

Sabah Bank Bhd v. Ho Juan Hua & Anor [1993] 3 MLJ 113 ***(refd)***

Selva Kumar Murugiah v. Thiagarajah Retnasamy [1995] 2 CLJ 375 ***(refd)***

South East Asia Insurance Bhd v. Nasir Ibrahim [1992] 2 MLJ 355 ***(refd)***

Sundar Koer v. Raj Sham Krishen [1906] 34 IA 9 ***(not foll)***

United Asian Bank Bhd v. Dyalchands Sdn Bhd & Ors [1994] 1 AMR 11:624 ***(refd)***

Legislation referred to:

Contracts Act 1950, ss. 75, 80, 82

Rules of the High Court 1980, O. 14 r. 3

For the plaintiff - S Ramesh; M/s Kassim Tadin, Wai & Co.
For the defendants - CY Chong; M/s CY Chong & Assocs

Reported by Raja Vishnu

JUDGMENT

Abdul Wahab Patail J:

The Facts

On 6 June 1996 the plaintiff Malayan Banking Berhad had made an offer of a loan of RM7,629,643 to the first defendant Chong Hin Trading Co Sdn Bhd. One of the terms included in the loan offer and memorandum of charges is the charging of a penalty interest of 1%. The loan was disbursed on 1 October 1996 after the memorandum of charges were executed on 12 September 1996.

The second and third defendants, Dato' Lem Lee Siang and Lim Siw Cheng, executed a guarantee in respect of the loan on 12 September 1996.

This has come before me as an appeal by the defendants to the judge in chambers from the decision of the learned Senior Assistant Registrar made on 30 September 1999 and who had allowed the plaintiff to enter summary judgment under O. 14 of the Rules of the High Court 1980 for costs, the sum of RM4,871,324.63 and interest thereon:

> Faedah atas jumlah RM4,871,324.63 pada kadar 2.25% setahun diatas Kadar Asas Pinjaman (Base Lending Rate) sebanyak 7.65% dan faedah penalti 1% kesemuanya atas kiraan bulanan dari 1 hb Julai 1999 sehingga ketarikh penyelesaian penuh;

The Issues

Two principal issues are raised in this appeal:

1) Whether penalty interest is contrary to s. 75 of the Contracts Act 1950.
2) Whether in view of s. 80 of the Contracts Act 1950, the guarantee is null and void because the loan is a past consideration.

Section 75

Section 75 of the Contracts Act 1950 deals with contractual provisions relating to penalty:

75. Compensation for breach of contract where penalty stipulated for.

When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract **reasonable compensation not exceeding the amount so named** or, as the case may be, the penalty stipulated for.

Explanation – A stipulation for increased interest from the date of default may be a stipulation by way of penalty.

Exception – When any person enters into any bail-bond, recognizance, or other instrument of the same nature, or, under the provisions of any law, or under the orders of the Federal Government or the Government of any State, gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable, upon breach of the condition of any such instrument, to pay the whole sum mentioned therein.

Explanation – A person who enters into a contract with Government does not necessarily thereby undertake any public duty, or promise to do an act in which the public are interested.

ILLUSTRATIONS

(a) *A* contracts with *B* to pay *B* $1,000, if he fails to pay *B* $500 on a given day. *A* fails to pay *B* $500 on that day, *B* is entitled to recover from *A* such compensation, not exceeding $1,000, as the court considers reasonable.

(b) *A* contracts with *B* that, if A practises as a surgeon within Calcutta, he will pay *B* $5,000. A practises as a surgeon in Calcutta. *B* is entitled to such compensation, not exceeding $5,000, as the court considers reasonable.

(c) *A* gives a recognizance binding him in a penalty of $500 to appear in court on a certain day. He forfeits his recognizance. He is liable to pay the whole penalty.

(d) *A* gives *B* a bond for the repayment of $1,000 with interest at 12 per cent, at the end of six months, with a stipulation that, in case of default, interest shall be payable at the rate of 75 per cent, from the date of default. This is a stipulation by way of penalty, and *B* is only entitled to recover from *A* such compensation as the court considers reasonable.

(e) *A* who owes money to *B*, a moneylender, undertakes to repay him by delivering to him 10 gantangs of grain on a certain date, and stipulates that, in the event of his not delivering the stipulated amount by the stipulated date, he shall be liable to deliver 20 gantangs. This is a stipulation by way of penalty, and *B* is only entitled to reasonable compensation in case of breach.

(f) *A* undertakes to repay *B* a loan of $1,000 by five equal monthly instalments, with a stipulation that, in default of payment of any instalment, the whole shall become due. This stipulation is not by way of penalty, and the contract may be enforced according to its terms.

(g) *A* borrows $100 from *B* and gives him a bond for $200 payable by five yearly instalments of $40, with a stipulation that, in default of payment of any instalment, the whole shall become due. This is a stipulation by way of penalty.

In *Realvest Properties Sdn Bhd v. Co-operative Central Bank Ltd* [1996] 3 CLJ 823, the Federal Court had occasion to consider the application of s. 75. In that case, the memorandum of charges prescribed interest at the rate of 14.75% per annum with monthly rests, and it was provided that in the event any amount due, whether principal or interest, was not received on due date, the chargor shall pay interest at the rate of one and one-third (1 1/3) times of the normal ruling rate of interest on the sum in arrears calculated from the date the payment is due until the date of actual payment. The Federal Court held that default interest may or may not be a penalty depending upon the circumstances, and common law remains applicable in interpreting whether a payment is a penalty or liquidated damages. The Federal Court followed the Privy Council in *Sundar Koer v. Raj Sham Krishen* [1906] 34 IA 9, 833:

> The Indian courts have invariably held that where (as in the present case) the stipulation is retrospective and the increased interest runs from the date of the bond and not merely from the date of the default, it is always to be considered as a penalty, **because an additional money payment in that case becomes immediately payable** by the mortgagor. Their Lordships accept this view of the statute. [Emphasis added]

It was held that since the provision involved the element of an additional money payment, in that the evidence shows that default interest of 20% was to be paid side by side with the amount due as principal and interest of 14.5%, the provision is unenforceable by virtue of s. 75. His Lordship Peh Swee Chin FCJ in following *Sundar Koer v. Raj Sham Krishen* said:

> Reverting to facts in the instant appeal, what we have is something out of the ordinary. Ordinarily, in provisions for loans of money, if default is made by the borrower, the borrower is made to pay **increased interest by means of a higher rate of interest in place of the lower rate of interest prevailing or payable before default**. Therefore, arrears arising from default are subject to one single payment of interest still, tough at a higher rate after default. It has been held or approved by the Privy Council that such default interest, if made payable from the date of contract (as distinct from the date of default), always amounts to a penalty. [Emphasis added]

The distinction drawn by His Lordship is between an additional payment over and above the normal payment and a payment at increased interest in place of the rate prevailing or before the default. In this case, para. 6 of the section on "Other terms and conditions" in the terms of loan offer dated 6 June 1996 provide that:

> Interest charged should be settled before he end or the following month. Without prejudice to any other right of the Bank, the Bank may debit your Account with the interest charged and impose a penalty interest of 1% p.a or such higher rate as shall be imposed by the Bank at any time from time to time above the prescribed rate on any late payment or instalment with minimum of RM1.00.

The wording is that it is an additional sum over and above the normal interest payment, and not in place of the rate prevailing before default. The memorandum of charges is not entirely clear. It provides:

> 10. DEFAULT INTEREST
>
> (A) **Interest on Overdue Sums:** If the Chargor does not pay sum payable under this Memorandum of Charge on Shares (including, without limitation, any sum payable under this Clause) when due, it shall pay interest on the amount from time to time outstanding in respect of that overdue sum for the period beginning on its due date ending on the date of its' receipt by the Lender (both before and after judgement) at such rate as the Lender may impose in accordance with the normal practice of the Lender.
>
> (B) **Compounding of Default Interest:** Interest accrued under this Clause on an overdue sum may at the discretion of the Lender be added to that overdue sum and itself bear interest accordingly and may at the discretion of the Lender be capitalised on the last business day of each calendar month in accordance with the normal practice of the Lender.

The words "shall pay interest on the amount from time to time outstanding in respect of that overdue sum for the period beginning on its due date ending on the date of its' receipt by the lender (both before and after judgment) at such rate as the lender may impose in accordance with the normal practice

of the lender" does not specifically mean it is an interest rate in place of the original interest rate prevailing at the time of default, and could well be an additional interest in addition to the original interest. Indeed since the amount outstanding would include principal and interest, these words would mean that it is intended as an amount in addition to the interest rate prevailing at the time of default.

The letter of demand by the solicitors of the plaintiff, M/s. Kassim Tadin, Wai & Co make it clear it is an additional penalty payment:

> Our clients' instructions are to demand from you, which we hereby do, that you are to make full settlement of the outstanding balance of RNB,064,037.72 as at 31/1/1998 together with interest thereon at the rate of 2.25% per annum above Base Lending Rate (currently BLR is 11.40% per annum) and an additional 1% penalty interest on the whole outstanding amount, calculated on monthly rests from 1/8/1998 to date of full settlement under said Term Loan Account No. 4-14011-9-4534-9 Facility and owing by yourself to our clients within FOURTEEN (14) DAYS of receipt of this letter hereof.

The above is also consistent with the certificate of Chai Su Boon (exh. CSB8), and the statement of accounts therein setting forth the penalty interest separately and in addition to the interest under the loan.

In all the circumstances the evidence is clear that the default interest is a separate payment in addition to the interest rate otherwise prevailing upon the loan at the time of default. As such *Sundar Koer v. Raj Sham Krishen* is not applicable, and since the payment is a penalty, s. 75 remains applicable to render the default interest provision unenforceable.

While *Sundar Koer v. Raj Sham Krishen* deal with circumstances where there is no additional payment, *Selva Kumar Murugiah v. Thiagarajah Retnasamy* [1995] 2 CLJ 375 FC, deals with a case where there is an additional payment. The explanation in s. 75 that a stipulation for increased interest from the date of default may be a stipulation by way of penalty makes it abundantly clear that the increase in interest may, unless otherwise explained, be a penalty.

The plaintiff cited *Bumiputra Merchant Banker Berhad v. The Melewar Corporation Berhad & Ors* [1990] 2 CLJ 30 and *United Asian Bank Berhad v. Dyalchands Sdn Bhd & Ors* [1994] 1 AMR 11:624. In the light of the Federal Court decisions in *Selva Kumar Murugiah v. Thiagarajah Retnasamy* and *Realvest Properties Sdn Bhd v. Co-operative Central Bank Ltd*, that High Court decision can no longer be considered good law. *United Asian Bank Berhad v. Dyalchands Sdn Bhd & Ors* can be of no assistance since s. 75 was not addressed, and the issue as to the interest raised by the guarantors related to the question whether they ought to be served with the notice as to the interest rate.

In this case the 1% interest in the memorandum of charges is clearly described as penalty interest in the letter of offer, slightly less obvious in the memorandum of charges themselves, but any doubt is dispelled by the treatment and description of the payment as a penalty interest in the solicitors letter of demand, the certificate of Chai Su Boon and the statement attached thereto. Therefore any submission whether it is a penalty or liquidated damages is an exercise in futility. As a penalty interest, the effect of s. 75 is to require the plaintiff to prove his damages and the 1% operates as the upper limit that may be claimed as damages. But as explained in *Selva Kumar Murugiah v. Thiagarajah Retnasamy*, the plaintiff must prove the damages that he suffered, the established measure for which is the damages for the loss of use of the fund or money.

In this case there is no evidence that the 1% is the damages suffered by the plaintiff from the loss of use of the amount due. That the 1% is not exorbitant or not is not a criterion in deciding whether the amount is a fair estimate by the parties of liquidated damages. The Singapore case of *Hong Leong Finance Ltd v. Tan Gin Huay & Anor* [1999] 2 SLR 153, should not be misunderstood as suggesting that a penalty interest is not a penalty if it is not extravagant, out of proportion, or unconscionable. In that case the interest concerned was described as default interest, and not as penalty interest as in this case. A sum does not cease to be damages merely because it appears high, although excessiveness would tend to show it is a penalty. In any case, the argument that it is liquidated damages is clearly not supported by the facts in this case.

Since the damages is disputed, an O. 14 summary judgment cannot be entered for damages. That however does not prevent judgment to be entered upon other parts of the claim that is not disputed.

Section 80

The second issue relates to s. 80 of the Contracts Act 1950 which provides as follows:

> 80. Consideration for guarantee.
>
> Anything done, or any promise made, for the benefit of the principal debtor may be a sufficient consideration to the surety for giving the guarantee.
>
> **ILLUSTRATIONS**
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> (a) *B* requests *A* to sell and deliver to him goods on credit. *A* agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of *A*'s promise to deliver the goods. This is a sufficient consideration for C's promise.

(b) *A* sells and delivers goods to *B*. C afterwards requests *A* to forbear to sue *B* for debt for a year, and promises that, if he does so, C will pay for them in default of payment by *B*. *A* agrees to forbear as requested. This is a sufficient consideration for C's promise.

(c) *A* sells and delivers goods to *B*. C afterwards, without consideration, agrees to pay for them in default of *B*. The agreement is void.

The second and third defendants relied on s. 80 illustration (c) on the grounds that they signed the letters of guarantee on 12 September 1996 when the loan agreement was made on 6 June 1996.

Illustration (c) above is a provision which is specific. It provides that where the promise in the original transaction has already been performed (A sells and delivers goods to B) and that without consideration, the guarantor subsequently executes an agreement to undertake liability for payment by the buyer (C afterwards, without consideration, agrees to pay for them in default of B), the agreement is void. Thus it has been held by the Federal Court in *Chew Soon Tat v. Malaysia National Insurance Sdn Bhd* [1977] MLJ 241 FC that a guarantor can only be liable for debts or liabilities incurred after the date of his guarantee. Mohamed Azmi J in *Perbadanan Kemajuan Negeri Selangor v. Public Bank Bhd* [1980] 1 MLJ 172 held that a contract of guarantee executed after anything done or any promise made for the benefit of the principal debtor does not constitute consideration for the guarantee. It was held that a benefit must be given either at the time of the execution or in the future but a past benefit is insufficient. That case was followed by Zakaria Yatim J (as he then was) in *Perwira Habib Bank Malaysia Berhad v. Utara Realty Sdn Bhd & Ors* Suit No. C3-23-3100-86 in the High Court in Malaya (Commercial Division). A guarantee is not necessarily limited to the liability at the time the guarantee is signed. A continuing guarantee is valid (see *Heng Cheng Swee v. Bangkok Bank Ltd* [1976] 1 MLJ 267 FC in respect of liabilities that arise are in the future.

It is obvious therefore that to determine the rights of the parties it is necessary to look into the specific terms of the guarantee. The letter of guarantee in this case clearly states:

> In consideration of you having opened, opening or continuing an account with and having made, making or continuing to make advances, loans, or otherwise having given, giving credit or accommodation or granting time to CHONG HIN TRADING COMPANY ... (hereinafter called "the Customer") ... The undersigned hereby jointly and severally agree with and guarantee you as follows:
>
> 1. I/We will pay you on demand:
>
> (i) all moneys which now are or may during the operation of this guarantee be owing to you from the Customer or remain unpaid on the general balance of the Customer's account with you ... .

The ground that the second and the third defendants signed the letters of guarantee on 12 September 1996 when the loan agreement was made on 6 June 1996 is incomplete in that it fails to take into account that the loan was disbursed on 1 October 1996, that is, after the memorandum of charges and the letter of guarantee was signed by the principal debtor and by the second and third defendants respectively; and in particular, although the transaction seem to suggest that the guarantee is a one-off guarantee and not a continuing guarantee as defined in s. 82, the guarantee did in fact commit to guaranteeing the sums of the sum remaining unpaid from that single loan. The letter of offer dated 6 June 1996 which was accepted by the first defendant contained specific conditions requiring pledges of shares and the joint and several guarantee of the second and third defendants. The agreement with conditions yet to be performed cannot be termed as a past consideration within the meaning of illus. (c) of s. 80 where the execution of the guarantee is itself a pre-condition for the performance of the loan by the plaintiff by the release of the loan on 1 October 1996. The series of events is one single transaction, even when considered on a strictly chronological view. Indeed in *South East Asia Insurance Bhd v. Nasir Ibrahim* [1992] 2 MLJ 355 SC it was held by the Supreme Court that the Court ought not take a strictly chronological view. In *Perwira Habib Bank Malaysia Bhd v. MET Sdn Bhd & Ors* [1988] 2 CLJ 480 an appeal in a case where guarantees were signed after approval of an overdraft facility but before the first drawdown was held to be valid. See also *Sabah Bank Bhd v. Ho Juan Hua & Anor* [1993] 3 MLJ 113; *Perwira Habib Bank Malaysia Bhd v. Saiyo Sdn Bhd & 2 Ors* [1991] 3 CLJ 1849; *D & C Bank Bhd v. Syarikat Farmco Sdn Bhd & Ors* [1988] 3 MLJ 275. I do not therefore find the second objection to be of substance and I would reject it.

Since the issues raised are purely legal in nature, and do not involve findings upon disputed facts, there is no reason to set aside the entire order of the learned Senior Assistant Registrar. I am satisfied the only triable issue is on the question of what is the actual damage suffered by the plaintiff as a result of the default, and not in respect of the principal sum and interest defaulted upon. Now O. 14 r. 3 of the Rules of the High Court provides that the court may allow partial judgment to be entered in an O. 14 application. Mindful of the fact the issue and the remedy of actual damage suffered is entirely separate from the issue of principal and interest due under the loan, I would vary the order of the learned Senior Assistant Registrar by deducting therefrom the penalty interest of 1%, and order that leave is given to the defendants to defend upon the issue of actual damage suffered by the plaintiff as a result of the default.